INDEX

	Page
Opinion below	1
Jurisdiction	1
Question presented	1
Statement	2
Argument	9
Conclusion	12

CITATIONS

Cases:

Henzel v. *United States*, 296 F. 2d 650	12
Lagow v. *United States*, 159 F. 2d 245, certiorari denied, 331 U.S. 858	11
Small Business Administration v. *Ray*, Civ. No. 9587 (W.D. La.)	3
United States v. *Culver*, 224 F. Supp. 419	12
United States v. *H.J.K. Theatre Corp.*, 236 F. 2d 502, certiorari denied *sub. nom. Rosenblum* v. *United States*, 352 U.S. 969	12
United States v. *Ray*, 234 Supp. 371	9
Zap v. *United States*, 328 U.S. 624, vacated, 330 U.S. 800	11

Statutes and rules:

15 U.S.C. 681(b)	3
18 U.S.C. 1341	2

266-436—67

In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 103

LOUIS M. RAY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the court of appeals (Pet. App. A) is reported at 374 F. 2d 638.

JURISDICTION

The judgment of the court of appeals was entered on March 23, 1967. The petition for a writ of certiorari was filed on April 20, 1967. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether evidence obtained by grand jury subpoenas should have been suppressed because of a prior examination by agents of the Small Business Administration.

STATEMENT

After a jury trial in the United States District Court for the Western District of Louisiana, petitioner was convicted of seven counts of mail fraud, 18 U.S.C. 1341. On October 25, 1965, he was sentenced to fourteen months' imprisonment on each of six counts, the sentences to run concurrently, and to five years' probation on the seventh count, to be consecutive to the prison term.[1] The court of appeals affirmed (Pet. App. A).

The evidence (its sufficiency is not in issue) showed that petitioner in 1962 obtained a license from the Small Business Administration for his wholly owned company, the First Louisiana Investment Corporation, ("FLIC"), and thereafter received $450,000 in SBA loans and "matching" funds. Part of FLIC's purported initial capital was nonexistent; and subsequent increases in its capital—which the federal money was intended to "match"—resulted from bogus transactions in which FLIC would "lend" money to corporations controlled by petitioner and the money would be returned to FLIC as "new" capital via bank accounts also under petitioner's control.

1. During the course of the trial, petitioner's counsel made motions to suppress the evidence on the ground that it had been obtained as the result of an illegal search conducted by examiners of the SBA. A

[1] Petitioner was acquitted of three counts of making false statements.

transcript of a prior civil proceeding was introduced for the purpose of deciding the motions (R. 50).[2]

The evidence in the transcript and at the hearing revealed that when petitioner applied for a license for FLIC from the SBA, he submitted, as required by law, 15 U.S.C. 681(b), the Articles of Incorporation of FLIC to SBA for approval. Two of the Articles obligated FLIC (Tr. 464):

> (h) To conduct its operations in accordance with and subject to regulations prescribed by Small Business Administration * * * [a]nd
>
> (i) To submit to and pay for examinations made by direction of the Small Business Administration by examiners selected, employed or approved by Small Business Administration.

Petitioner represented in the license application that FLIC had at least $150,000 in unencumbered paid-in capital and surplus from private sources. An examination of FLIC in June 1962 by the SBA disclosed, however, that between January and April 1962 (both before and after FLIC received the license) petitioner withdrew the entire amount which had constituted FLIC's initial capitalization (Tr. 456–458, 475–476, 558).[3] In addition, FLIC had made loans to other corporations controlled by petitioner and these loans lacked adequate security and were in default; FLIC's

[2] "R." refers to the transcript of proceedings at trial. "Tr." refers to the transcript of the prior civil proceeding, *Small Business Administration* v. *Ray*, Civ. No. 9587 (W.D. La.), a copy of which has been lodged with the Clerk of this Court.

[3] Also—though not known to the SBA at the time—$60,000 of FLIC's ostensible $150,000 original capital was nonexistent—the result of a fictitious transaction between petitioner and one Crisler utilizing the intermediary of a "dummy" corporation controlled by petitioner (see R. 760–765).

fidelity bond had been revoked; and there were other violations of SBA regulations (Tr. 297). Petitioner, notified of these findings, submitted documents indicating that the money had been returned to FLIC, and he promised that he would try to obtain collateral for the loans and remedy his deficient bookkeeping practices. On the basis of petitioner's assurances SBA in November 1962 decided to continue FLIC as a licensee (Tr. 300–301, 476–477).

On June 3 or 4, 1963, one Schutz, an examiner for SBA, learned that another SBA licensee had in November 1962 loaned $110,000 to two companies controlled by petitioner and that at approximately the same time FLIC's capital had increased by $100,000 and FLIC had applied for matching loans from SBA (Tr. 299, 477–478, 485, 486, 488–489). Schutz wrote a memorandum on June 5, 1963, setting forth the facts regarding FLIC known to the SBA at the time and recommending a full examination of FLIC's activities. In his memorandum he stated (Tr. 491–492):

> In view of our past experience with Mr. Ray and [FLIC], this examiner believes there is a strong possibility that the funds obtained by Charmingdale Bus and Realty Construction [the two companies which petitioner controlled] may have been channeled into [FLIC] some time between October 1, 1962 and December 31, 1962, so as to increase the licensee's paid-in capital and surplus to the tune of $100,000.
>
> The wholly owned business activities of Louis Ray lend themselves to a pyramiding operation which the timing of loans to Charmingdale Bus

Company and Realty Construction and the increase in Licensee's paid-in capital confirm.

Permission to conduct an examination of FLIC was immediately granted.

On June 6, 1963, Schutz went to Monroe, Louisiana, where the offices of FLIC were located. The agency (and Schutz) knew from financial statements on file at the SBA that several companies listed as borrowers from FLIC appeared also to have their headquarters in Monroe (see Tr. 321–325). Schutz was unable to find the companies mentioned on the tax rolls. Nor could he find addresses for them in the telephone directory. On the morning of June 7, 1963, he proceeded to the local courthouse and examined the charters of the companies. He learned that two of the borrower corporations had been organized only two days before receiving $100,000 loans from FLIC; that their articles of incorporation had not been filed until after the loans had been made; that the incorporators and stockholder-officers were the same for both corporations; that the addresses and principal offices of the companies were either that of petitioner's attorney or a former address of FLIC itself; and that employees of petitioner were among the incorporators, officers and shareholders of the companies (Tr. 495–497, 500–504).

In the afternoon of June 7, Schutz and a subordinate named Moore went to the offices of FLIC. The examiners entered the building and first encountered one Hathaway to whom they identified themselves and told of their purpose to inspect FLIC's records (Tr. 212, 508). Hathaway left to get one Sims, an

employee of FLIC. While he was gone Schutz walked down a corridor and glanced through an open door. He saw what appeared to be journals and ledgers lying on the floor near a desk (Tr. 508, 510). He walked back and met Sims. Sims said that he would have to telephone petitioner, who was in Florida; he had no authority himself to let the men look at the records (R. 371; Tr. 101, 511–512, 514). Sims telephoned petitioner and put Schutz on the line. Schutz told petitioner he was from the SBA and would like to examine FLIC's records (Tr. 20, 514). Petitioner told Schutz that he could not see the records at that time because they were locked up and he and his other employees who had keys were with him in Florida. He indicated that he would be glad to let the agents examine the records when he returned in about a week (Tr. 20–21, 26, 380, 516, 542–544). Sims testified that when petitioner had finished speaking to Schutz, petitioner flatly instructed Sims not to let the examiners look at the records (Tr. 22–23, 41, 129, 163; but see Tr. 192).

After concluding the conversation with petitioner, Schutz noticed that the door of the safe in the room was ajar and the safe empty (Tr. 516–517, 595, 597). Believing that petitioner had lied or was mistaken about the records being locked up, he asked Sims, "Do you mind if we look around?" (Tr. 517, 550). According to both Schutz and Moore, Sims' response to this question was to shrug his shoulders as if he "didn't care" (Tr. 517, 550, 597). The agents proceeded to the room where Schutz had seen the records

when he first came in (Tr. 517–518).[4] Sims entered the room a few minutes later (Tr. 552). Schutz again inquired whether he minded if they looked at the records. Sims again shrugged (Tr. 519). According to the examiners, he never objected to their inspection (Tr. 519, 528, 600). Sims, however, testified that he told the agents that they could not see the records, and ordered them to stop (R. 37–38; Tr. 104–107, 130). The agents examined cancelled checks of FLIC and of several corporations that were borrowers from FLIC (Tr. 317–325, 437–439). The names of the borrower companies whose checks the agents examined (*e.g.* Holiday Hotel, Trends Builders, Louisiana Brick, Consolidated Contractors, Rapides Land, U.S. Engineering) were in all cases known to the SBA from statements filed with the SBA by petitioner showing transactions of FLIC with these companies (Tr. 317–325, 437–439, 574). The checks were in boxes on the floor, with pieces of paper separating checks belonging to different companies (Tr. 126, 282–283, 575–576). Sims stayed in the room and watched the agents make their examination (Tr. 520–521). The agents remained at the premises from 2:00 p.m. to 5:00 p.m. when they were asked by Sims to leave since Sims himself had to go (Tr. 525–526).

The agents came back the next morning to resume their examination but Sims refused to let them enter, saying that he had spoken to petitioner in the mean-

[4] This room was actually the office of petitioner's accountant, but there was nothing to indicate that it was not part of the FLIC premises (Tr. 56–57, 195).

time and that petitioner had told him not to admit them (Tr. 110, 529). Schutz and Moore thereupon left.

On June 17, after petitioner had returned from Florida, Schutz and one Levy conducted a full examination of FLIC's records with petitioner's permission (Tr. 28–29, 311–312). Petitioner did not at that time indicate any objection to the June 7 inspection (Tr. 312).

The SBA subsequently served subpoenas on petitioner requiring production of the records of the borrower corporations of FLIC known to be controlled by him (Tr. 319–325). Petitioner did not comply with the subpoenas and an enforcement proceeding was instituted in the federal district court.[5] While the case was pending, the United States brought suit against petitioner and FLIC, alleging that FLIC's obligations to the SBA were delinquent and that petitioner had wrongfully diverted SBA funds. A receiver appointed by the district court took possession of the FLIC books and records and placed the documents in the custody of the court. Some time later, the government presented to a grand jury in the District of Columbia evidence which resulted in the mail fraud indictment in the present case. A grand jury subpoena duces tecum was issued to the Clerk of the Louisiana District Court for the FLIC records in its custody and on July 10, 1964, by order of the district judge, the records were turned over to the grand jury. The subsequent prosecution in the District of Columbia was transferred to the Western

[5] The transcript of this proceeding contains the testimony concerning the circumstances of the June 7 examination and is the one that was admitted into evidence at petitioner's trial.

District of Louisiana. *United States* v. *Ray*, 234 F.Supp. 371 (D.D.C.).

2. The district court found it unnecessary to determine whether the inspection by Schutz and Moore on June 7, 1963, had been proper, since it found that the government had sufficient independent knowledge of petitioner's and FLIC's activities to justify the subpoena of FLIC's records in connection with the grand jury investigation (R. 41). The court of appeals ruled that the June 7 inspection by SBA examiners of the records of FLIC was valid notwithstanding the fact that petitioner refused to permit the examination, since the right of SBA examiners to see the records, where no breaking or entering was involved, did not depend on the presence or then consent of petitioner. As to the records of the corporate borrowers from FLIC, the court found that the data procured by lawful examination of the FLIC records provided sufficient independent ground for requiring the production of such records whether or not the examination of the records of the borrowers on June 7 had been justified.

ARGUMENT

The question in this case is whether the subpoenaed records were inadmissible in petitioner's criminal trial as the fruit of the June 7 inspection. We submit not. First, they had an independent source. Second, the June 7 inspection was lawful.

1. The record clearly establishes, as the district court found, that before the June 7 examination of the books and records SBA had sufficient information

of wrongdoing by FLIC and misuse of the borrower corporations that there would have been an investigation of petitioner and FLIC, and subpoenas to the borrower corporations, whether or not the June 7 examination had taken place. Schutz testified that the facts obtained from the June 7 inspection were "repetitious" of information already in the SBA's files and merely "confirmed" prior suspicions regarding petitioner's unlawful conduct (R. 64, 66, 68; Tr. 439, 578–579). The facts set forth in the statement fully support these assertions. Briefly to summarize: Following the initial near-cancellation of FLIC's SBA license in November 1962 for various breaches of SBA regulations, SBA learned on June 3 or 4, 1963, that FLIC's capital had increased by $100,000 at a time when two companies controlled by petitioner had received loans of approximately that amount from another SBA licensee. Before the June 7 inspection Schutz had also learned from the charters of various borrower corporations of FLIC that these corporations were organized and controlled by petitioner apparently for the sole purpose of acting as recipients of alleged "investments" by FLIC. The existence of all of the borrower corporations whose checks were observed on June 7 was known to the SBA from statements filed by petitioner for FLIC showing transactions with such companies. Moreover, after the June 7 examination, there was an examination of FLIC records with petitioner's consent on June 17. These records also disclosed the existence of the borrower corporation and the need to examine their records.

2. Petitioner's challenge to the legality of the June 7 examination overlooks the fact that the articles of incorporation of FLIC included a consent to examination of its books and records by the SBA. The company was organized for the sole purpose of doing business under the auspices of and with funds contributed by the SBA. The provision in its charter consenting to inspections by SBA examiners was a reasonable condition of the agency's licensing such an operation. In these circumstances, SBA agents did not need the express consent of any representative of the corporation to examine the records. See *Zap* v. *United States,* 328 U.S. 624, vacated on other grounds, 330 U.S. 800.[6] Nor is it clear that consent was in fact withheld. Petitioner's own testimony indicates that he told the examiners that the records could not be examined because they were locked up and no one then on the premises had the key. When the examiners saw that the records were in fact open to view, they had every right to rely upon the corporate consent given in the articles of incorporation as grounds for inspection of the records.[7]

[6] We do not suggest that the agents would have been justified in making a forcible entry in the face of an attempt to bar them; but nothing of that sort happened here. When on June 8 Sims declined to admit the agents, they did not enter.

[7] Nor is it clear that petitioner has standing to challenge the inspection of records of FLIC and of the borrower corporations. Several cases have held that an individual who chooses the corporate form of transacting business may not repudiate the separate corporate identity in order to complain that papers of the corporation are "his" when used against him in a criminal trial. *E.g.*, *Lagow* v. *United States*, 159 F. 2d 245 (C.A. 2), certiorari denied, 331 U.S. 858; *United States* v.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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JUNE 1967.

H. J. K. Theatre Corp., 236 F. 2d 502 (C.A. 2), certiorari denied *sub nom. Rosenblum* v. *United States*, 352 U.S. 969; *United States* v. *Culver*, 224 F. Supp. 419, 427–429 (D. Md.). *Henzel* v. *United States*, 296 F. 2d 650 (C.A. 5), looks the other way, but may be distinguished as involving the seizure of corporate records from the private office of the corporation's president and sole stockholder.

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